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THE ETHICS OF THE WAGES AND PROFIT SYSTEM.

EUGENE W. LYMAN.

ONE has the feeling that a discussion of this subject is likely to be regarded, in many circles, as an act either of impiety or frivolity. Is it not impiety to call in question a system with which all the goods of life are bound up? Are we not forgetting the rock from which we were hewn, the pit from which we were digged, when we turn scrutinizingly upon the system upon which both production and philanthropy depend? Or, if the examination of such a matter does not produce a kind of ceremonial defilement, is it not a frivolous undertaking, for the reason that the wages and profit system is the outworking of natural law? Might not one as well compare gravitation with levitation from the standpoint of value as to compare the wages and profit system with any alternative from the standpoint of ethics?

Now foreign as such attitudes are to the philosopher, they should not be ignored by any who aspire to the philosophic mind. For it is the direct business of the philosopher to counteract these attitudes. In this matter the philosophic mind must become missionary. More important to the philosopher than the maintenance of any economic system, or the establishment of some new system, is the persistent examination of any and every economic system from the standpoint of ethics. And the purpose to secure such a persistent examination the philosopher is bound to seek to propagate as widely as possible among his fellowmen.

I.

But what is the wages and profit system which ethics must summon before it for review? Obviously in attempting to answer this preliminary question it is only the main

structural lines of that system with which we are concerned, rather than any of its accessory ornaments or blemishes—such as munificent philanthropies or illegal profiteering. But there are two ways of getting at these main structural lines, to each of which we must give some attention.

The one way is to go back to certain elementary instances of the economic process—the fisherman in his dugout, or the solitary laborer cultivating “no-rent” land—and to find in these the needed simplification of our present confusing industrial situation, and the needed principles for its interpretation. The economic order, according to this procedure, is like an old colonial house which has been disfigured by all sorts of “L’s” and lean-tos attached by willful or thoughtless inheritors of the place, but whose main lines are excellent, and which, therefore, requires only to have the clutter of disfiguring additions removed and replaced by a few broad piazzas to be a commodious and beautiful dwelling.

The other way of getting at the structural lines of the wages and profit system assumes that the modern developments of the economic process—trusts, labor unions, banking systems, and the interweaving of the foreign policies of governments and of business syndicates with each other—that these developments involve principles which in important respects are different from those that entered into the economic process in previous stages, and which yet are only very unclearly connected with the earlier principles. According to this assumption the economic process is like the buildings of an expanding industrial plant, each one of which is more extensive and substantial than the last—the architectural problem being whether the building in which the business started is still valuable, and if so, how it should be related to the new parts of the plant.

Now for reasons that will be brought out a little farther on we must tentatively follow both these ways of defining the wages and profit system. According to the method of defining by going back to simpler forms this system is the

organization of production and distribution through the free contracting together of capital and labor, the motive of labor being wages and the motive of capital being profits—profits being the net income of the sale of products after wages and other expenses have been paid. The operation of this system, moreover, is held to reveal the working of a natural law by which social well-being is guarded and promoted. This law results from free competition—laborer competing with laborer for wages, laborer competing with himself by increasing his skill and effort so as to get higher wages, capital competing with capital for labor, and capital competing with capital for markets. The result of this law will be the organization of production so that more and more society secures the services it wants, and so that the income of production tends to get distributed in such a manner as to give each unit of capital and labor what it produces. Thus the result of the wages and profit system is ethical, both from the individual and the social point of view. Yet this ethical result comes about without any need for either the individual or society to aim at it—simply by natural law. The most that society needs to do is not to interfere with the working of this law, nor to allow the individual to interfere with it. Hence the *laissez faire* theory of government is the counterpart of the wages and profit system in this more elementary form. Thus Adam Smith writes: “All systems either of preference or restraint . . . being . . . completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest in his own way, and to bring both his industry and capital into competition with those of any other man, or order of men.”¹ And even when this law is interfered with Adam Smith thinks it tends to assert itself and to secure comparative justice. “In the political body,” he says, “the wisdom of nature has fortunately made

¹ *Wealth of Nations* (ed. by J. E. T. Rogers, 2nd ed.), Vol. II, p. 272.
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ample provision for remedying many of the bad effects of the folly and injustice of man; in the same manner as is done in the natural body for remedying those of his sloth and intemperance."²

Now in spite of all the enormous changes that have come about in our economic situation through the introduction of machinery and the consequent organization of capital by itself, labor by capital, and labor by labor, the main structural lines of our present wages and profit system are held by most of its defenders to be such as this earlier theory portrayed. The changes of theory which are deemed necessary are such as will simply restore and amplify the old colonial dwelling. The word "profits," it is true, acquires, with most writers who take the view mentioned, a much more specialized meaning. A portion of what we have loosely called profits is now assigned to "wages of management," and a larger portion is, of course, more accurately spoken of as interest, so that the term "profits" becomes reserved for the surplus income beyond these other items. But the same natural law presides over the economic process. Thus Professor John B. Clark teaches that, in what he terms "a static society," labor gets what it produces and capital gets what it produces according to natural law. This natural law is that, under free competition, production will expand, adding more units of capital or labor, up to the margin where profit ceases and loss begins. What is produced by adding the final unit of capital or of labor will have to be all paid over to that unit. But if labor or capital can be gotten at that rate, nobody will pay any more. Thus labor and capital tend to get what they produce and only that. So Professor Seager says that "The law regulating the division of the product between labor and capital for a society in a state of normal equilibrium is . . . that each receives the share it produces." The earnings of the capital goods "at the margin of indifference will fix the general rate of interest," and "the

² *Op. cit.*, p. 259.

determination of the earnings of marginal workmen will serve indirectly to determine the wages of all.”³ The presupposition here, too, of course, is that there be “free, all-sided competition.”

The most interesting thing about this interpretation of the economic process is that profits in the more special sense disappear when the static society or the normal equilibrium is reached. All the income of society is distributed as interest and wages—including wages of management. And yet in our actual society, which is more or less dynamic, profits are conceived to play an all-important rôle. For “Profits cause competition that secures to labor its product,” says Professor Clark; “but competition tends to annihilate that profit and to make the pay of labor equal to the product of the final unit of it.”⁴ And the same can be said of the service that profits render to capital. Profits, thus, are the John the Baptist of the ideal economic order—in spite of the fact that they so little conduce to asceticism—for they are always saying to wages and interest, “You must increase, but I must decrease.” And without profits the Messianic age of complete economic justice, in which there are no profits, will never dawn.

But one may say: If actual society is not static but dynamic, in what sense can this natural law of final productivity be relied upon to secure economic justice? And anyway, what is the meaning of a law that is always being suspended? Professor Clark replies that the law is dominant in the dynamic society too, and always tending to get itself enforced. He uses the figure of the ocean. “There has never been a moment,” he says, “in the history of the stormiest seas, when the dominant forces that controlled them were not those which, if left entirely alone, would reduce their waters to a static condition. . . . With all the movements that winds and tides produce, these influences are still the dominant ones. The ocean does not leave its bed, and the depth of it does not greatly change.

³ *Principles of Economics*, p. 279.

⁴ *Distribution*, p. 179.

The surface, considering its size, shows only trifling irregularities."⁵ And so he affirms: "As real as gravitation is the force that draws the actual pay of men *toward* a standard that is set by the final productivity law. This law is universal and permanent: everywhere it will outlive the local and changeful influences that modify its operation. We are to get what we produce—such is the dominant rule of life."⁶

But now we must turn for a moment to the other way of defining the wages and profit system—that which begins with that system as it is in actual operation to-day, and which, therefore, is more inclined to leave open the question whether its main structural lines are the same as those of the system under simpler conditions, or whether perhaps those earlier lines have been obliterated.

We need not turn to the Marxian or the Syndicalist for this characterization of the wages and profit system, for it can be obtained from that system's friends.

"As business is now organized," Professor Seager writes, "the leading rôle is played by the enterpriser. From his point of view all the shares in distribution, except his own profit, are expenses of production. . . . From the viewpoint of motive, the first claim that must be considered is that of the enterpriser himself. . . . If we call the minimum profit necessary to induce him to continue to serve industrial society in his enterpriser capacity his wages of management, we may say that from the enterpriser's own standpoint this is the most important of the shares into which the annual money income must regularly be divided. In addition to the wages of management to which he is entitled, the enterpriser, who is the risk-bearer as well as the manager of the enterprise, may receive an additional profit or incur a loss."⁷ In further explanation of wages of management Seager says: "Such earnings are not necessarily small. 'Bare wages of management' may

⁵ *Op. cit.*, p. 402.

⁶ *Op. cit.*, p. 180.

⁷ *Op. cit.*, pp. 173, 4.

mean anything from the one dollar a day or less of the itinerant pedler to the \$50,000 a year or more of the highly successful business man. The point to be emphasized is that the same explanation that accounts for wages or salaries accounts also for the wages of management currently received by enterprisers of the same grade of capacity."⁸

The reason why the enterpriser has the leading rôle in modern business thus appears to be twofold. He is the manager of the business, and he is the risk-bearer. Now this latter aspect needs especial attention, for it is in connection with it that profits in the stricter sense of the term get their economic and ethical interpretation. Says Professor Seager: "When an industrial society is progressing and in each period there is more wealth to be divided among the sharers in distribution than in the preceding period, a large part of the increase will appear temporarily as extra profits going to its enterprisers. In the same way, when an industrial society is retrogressing the loss will fall first upon the enterprisers. . . . But whether the net balance happens to be above or below the wages of management, competition among enterprisers themselves is a force which tends constantly to make their gains correspond to bare wages. . . . Thus, however large profits or losses may be at any given time, they are always in the process of extinction—always, that is, unless monopoly influences intervene and prevent the forces of competition from accomplishing their work of elimination."⁹

Monopoly thus appears as a means for preventing the elimination of profits—a means which the enterpriser himself devises, thereby the more fully justifying his name. But the preservation of profits by monopoly takes place through the elimination of risk, and it is as risk-bearer that the profits are supposed rightfully to accrue to the enterpriser.

We now begin to see how far the structural lines of the

⁸ *Op. cit.*, p. 177.

⁹ *Op. cit.*, pp. 211–212.

simpler economic process have been changed in the present organization of production. Profits are the motive of the enterpriser as risk-bearer, which, as initiator or expander of business, is his more essential rôle. Profits, therefore, are the driving force in economic progress. But the law that each gets only what he produces becomes effective only so far as profits are eliminated. Thus the elimination of the driving force of economic progress is the condition on which economic justice depends. But on the other hand, in order to preserve profits which are the motive for the enterpriser's peculiar contribution to production, namely, risk-bearing, the enterpriser is impelled to eliminate risk through monopoly. Thus the perpetuation of the chief motive for economic progress leads to the suspension of the ethical justification of that motive.

Two large features of the economic process, therefore, tend to suspend the principles on which that process in its simpler form was held to depend. These features are: the dynamic character of society and the tendency towards monopoly, and these two features tend towards the perpetuation of profits, whereas it is on the elimination of profits that economic justice depends.

There is one more large feature of the economic process, recognized by Seager, which seriously complicates the working of the natural law that, on the simplified scheme, is relied on to secure economic justice. This additional complicating feature is "the unequal opportunities of workers." "Full weight," Seager says, "must also be given to the fact that, as industrial society is now organized, 'pull' is often more important than 'push' in helping a man to get on in the world. Competition is fairly effective as a means of eliminating the unfit, but complete equality of opportunity rarely prevails in the selection of those who are to be given a trial. Influence enables some to step without effort into important positions, which others, even better fitted for them, can only rise to, if at all, after long and painful struggle. The differences of the earnings of different workers in actual industrial society are due to

these considerations nearly, if not quite, as much as to the more narrowly economic influences."¹⁰

But Seager finds, further, that these inequalities of opportunity tend to perpetuate themselves. For with a low standard of living only meager educational opportunities are possible, or desired even, and without adequate educational opportunities one enters the competitive race handicapped to an indefinite amount. As Seager puts it: "The persistence of differences in industrial capacities among individuals is due chiefly to differences in educational opportunities which are due in turn to standards of living." Thus, according to some of the friends of the wages and profit system, that system has a strong infusion of economic determinism in it.

Now this inequality of opportunity must work to keep the final productivity of labor low. And if, by hypothesis, final productivity is the measure of wages, it must tend to keep all wages too low, and so to keep—perhaps, interest—but certainly profits—too high. Thus the profits of the enterpriser are bound up with the perpetuation of inequalities of opportunity for labor.

II.

We have dwelt too long, perhaps, upon this twofold characterization of the wages and profit system, but the recognition of these two aspects of that system as it is thought of by its defenders seems necessary for discussing its ethical bearings. And it permits me now to state a series of propositions that I hope to justify by some further exposition. These propositions are as follows: (1) The ethics most commonly appealed to as justifying the wages and profits system is the ethics of the original interpretation of that system, and this ethics, though relatively justified, rests upon a psychological fallacy which vitiates it for present day thought. (2) The wages and profit system as it now exists so far differs from its simpler forms that the

¹⁰ *Op. cit.*, p. 249.

attempt to transfer to it the earlier justification involves an ethical fallacy as well as the continuance of the psychological fallacy. (3) The complete abandonment of the earlier economic ethics runs the risk of abandoning the ethical standpoint altogether.

The ethics of the earlier economic theory is, as we already have seen, that of a free competition of self-interests which works out social justice by natural law. The beauty of this ethical theory is that no one need ever trouble to keep it in mind. Self-interest, if not interfered with, will take care of itself and of social justice too. In the economic world one gets social justice by forgetting it. The fallacy here is the well-known fallacy of composition—in this case the fallacy of expecting to get a social result without a social motive. The error of supposing that you can have this harmonious working together of a multitude of self-interests, in which no self-interest is suppressed, is that the self-interests naturally tend to suppress each other. This fallacy has been too often exposed for us to need to dwell upon it here. It is clear to us, of course, that man has other motives than those of self-interest. Did not Adam Smith himself base his theory of moral sentiments on sympathy? And it is clear also that the social motives, if they are to have the proper influence, must be cultivated. Of course none of the modern successors of Adam Smith ignores these facts. But they all do seem to persist in abstracting the economic world from the other spheres of human activity and assuming that in that world self-interest is the only motive to be reckoned with.

Now unfortunately any fallacy thoroughly insisted upon becomes a half-truth. By insisting that self-interest is the only motive to be considered in determining the laws of the economic world, one tends actually to segregate the economic world from social motives. However much social motives may be fostered by the school or the church, if the economic world is interpreted, and actually run, on the theory that self-interest is the only economic motive, the economic world becomes a powerful school for anti-

social motives. We, therefore, can only escape the damaging effect of this fallacy, which makes itself into a half-truth, by deliberately seeking to socialize the motives operative in the economic world itself. And by this I mean, not simply in a general way to socialize the individuals that make up the economic world, but to recognize the productive value of social motives throughout all sections of the economic process.

But I have said that the older economic ethics was relatively justified. This is because it was democratic in character. It was the ethics of a democratic individualism rather than of a socialized democracy, but still it was democratic. It presupposed that all would have equal opportunity when governmental interference and the privileges of hereditary castes were done away with, and it expected that each would come to his best in the economic world, except as he failed through his own fault. In any case each would get his just deserts. This democracy was much too optimistic and absent-minded—too optimistic because it assumed that when ancient oppressive institutions were done away with “nature” would take care of the rest; and absent-minded because as a middle class movement it forgot the proletariat. But it was a fine plough-share for breaking up the cake of custom and bringing much fallow ground in human society under cultivation.

And the economic order in which this individualistic democratic ethics has been the presiding genius of course has much to say for itself. Professor Tufts writes on this point: “Individualism can make out a strong case in respect to several of the ethical qualities which are demanded: viz., efficiency in production of goods, stimulation of active and forceful character, promotion of freedom and responsibility, encouragement to wide diversification of occupation and thus of services, and, finally, the supply of society with the kind of goods that society wants.”¹¹ Of course individualistic democracy cannot claim the sole

¹¹ Cf. *Ethics*, Dewey and Tufts, p. 527.

credit for the enormous advances of modern production, for as Tufts adds, science and education have also been leading factors in the matter. But I believe we should agree with him that individualistic democracy in turn has had an important share of the result to its credit. But this only gives the more point to the query whether greater and more consistent ethical results might not be secured by socializing the democratic principle in its application to the economic world.

But now we must pass to the second proposition. I think perhaps the first section of our discussion has sufficiently shown that the principal ethical justification employed for the wages and profit system as it now operates is still this older economic ethics. For however it may be recognized that the socialized individual is indispensable to modern society in general, still in economics self-interest is the motive almost exclusively dealt with by the friends of the present system, and for the regulation of self-interest natural law is their main reliance. Most of these thinkers of course would look to the state to regulate monopoly, and Professor Seager lays great stress on free education of a thorough and extended kind to remove inequalities of opportunity. But all leave profits to be regulated by natural law under free competition.

The main thing now is to point out, on the basis of what already has been said of the wages and profit system as it now operates, that it is aristocratic, if not autocratic, in principle, and hence that there is an ethical fallacy in looking to that system to vindicate itself on a democratic basis. By an "ethical fallacy" I do not mean simply the contradiction of expecting democracy from aristocracy. I mean the failure by reason of a formal democracy and an inherited democratic theory, to perceive, that the system as it now is organized can be justified only on an aristocratic basis.

The enterpriser, we are told, plays the leading rôle in modern business, and his rôle involves, on the one hand management, for which he receives wages, and on the other hand the risk-bearing due to his initiative, for which he

receives profits. Now these profits are the result of the dynamic character of society.¹² The enterpriser, therefore, tends to reap the benefits of the dynamic character of society. Now the alleged law of wages and interest works only in so far as profits are eliminated. Thus the enterpriser is a privileged party in the economic scheme, and one whose function, so far as it is determined by profits, lies outside the sphere of economic justice.

Of course, in theory, any one can be an enterpriser instead of a wage earner, a lender, or a simple manager. Anyone can at least turn to peddling—though if all turned enterprisers after this fashion the situation would resemble the island whose inhabitants were said to eke out a modest living by taking in each other's washing. But with our modern methods of trust organization the real enterprisers grow fewer and fewer. Marx was wrong, of course, in supposing that capital would follow the centripetal tendency to the exclusion of the centrifugal. The motive of interest from investment is certainly very widespread in our land. But if we substitute "*enterpriser rôle*" and "*profits*" for capital and interest, his forecast would not seem to be far wrong.

But, we are told, the enterprisers compete for profits with their fellows of the same capacity. This is far from enough to restore anything like a principle of democratic control. For the level at which the enterpriser competes is by no means determined solely by his own capacity, since below it lies a whole hierarchy of the inequalities of opportunity already mentioned. But once more we are told that the risks he must take involve a principle of control. This, however, is also far from adequate as a restraint. For the risks may be passed on to the wage earner by discharging him or laying him off; they may be

¹² Professor Seager mentions as the most important changes which occur and the principal causes of competitive profits: (1) price fluctuations; (2) introduction of novelties; (3) improvements in methods of production; (4) variations in climate or other natural conditions; (5) the exploitation of new lands and natural resources; and (6) modification in the rates of remuneration of other factors in production.

passed on to the investor by omitting dividends; they may be passed on to the public by limiting output.

Thus by segregating the rôle of enterpriser and allocating all the profits to those playing this rôle the modern economic process has built up within itself an irresponsible power, which, however wisely it may be exercised in many cases, can claim no justification on the principles of democracy. The hands stretched out to receive the blessings of society may seem to be the horny palms of labor or the kid-gloved hands of the coupon cutter, but the persuasive voice is that of the enterpriser, and as in the case of that prince of enterprisers, Jacob, it obtains the best blessing, while the hands that procure the venison for society arrive too late. Let us hope that the perpetuation of this ancient law of distribution is not due to senility or permanent blindness on the part of society.

But let me turn for a moment to the third proposition already advanced. One may abandon altogether the democratic justification of the economic process which has so long prevailed. This is done by those who hold that the law of the economic world must be the general evolutionary law of the survival of the fittest. And when this change is made it generally is assumed that it introduces an aristocratic standard of ethics in the place of the older democratic one. But in reality it is the abandonment of the ethical point of view altogether. For it makes economic power its own justification, whereas the ethical point of view requires the subordination of economic power to the total good of society. It is entirely possible to have an aristocratic theory of social good, but if the economic world is to be measured by it, economic power must be related to other and greater social goods by some positive law or principle. To call the law of the survival of the fittest in a purely economic struggle an ethical law is to exalt to ethical dignity the law of the jungle.

In conclusion it may be well to forestall the almost inevitable rejoinder to any criticism of an existing institution

or system, namely, What do you propose as an alternative, and how is that alternative to be introduced? It would lie beyond the scope of this paper to introduce such an alternative, but the position that our argument leads to is that no such alternative should be offered or demanded.

Lest this should seem to be mere sidestepping, let me explain that the attitude to which the ethical consideration of economic systems leads is that of social experimentation. Past and present systems have a certain relative justification and at the same time involve certain obvious evils. Ethics should seek to disentangle the principle on which the relative justification of past systems is based and to give it wider and more consistent application. Much of our present trouble is due to the fact that the older economic theory had an ethics which has been retained unreconstructed while wide social reconstruction has been taking place, and so has served to obscure the roots of our present evils and make them appear as largely good.

The principles that should guide us in social experimentation have emerged in the course of our criticism. They call for a socializing of the economic motive and a democratizing of economic method, thereby securing greater justice in distribution of income, and, as I believe, an equal, if not greater, productivity on the part of society.

These principles taken together give us the now familiar ideal of industrial democracy. But if this ideal is to be taken ethically, it must be taken seriously, with the expectation that it will progressively find concrete embodiment.

It is a great advantage in addressing ourselves to such a task that we do not have to set our present wages and profit system over against Marxian socialism, or Syndicalism, or Russian Sovietism, and choose between them. We have such transitional programs as that of the British Labor party, which puts forth as the four pillars of the house that is to be built: The universal enforcement of the national minimum; the democratic control of industry (involving nationalization of mines and transportation; the revolution

of national finance (carrying with it steeply graded scales of taxation); and the surplus for the common good. We have in our own country the Plumb Plan of railroad administration, which, if industrial democracy is the right ideal, should be scrutinized not hostilely but hopefully.

Such programs as these lead us to a development by which social groups democratically controlled shall be themselves the enterprisers and risk bearers and the recipients of profits. They point to a conception of the reward of labor as a share in a social product determined upon by democratic methods, instead of an allotment to each laborer of what he individually produces through the operation of an alleged natural law. And they give promise of far greater productivity in the economic process as a whole through awakening and developing the creative impulse in all members of the economic world.

If such suggestions seem too utopian, there is no reason for reacting against them in such a way as to throw ourselves into the attitude of social standpattism. For at least we can recognize the value of such a maxim as that supplied by John Dewey when he says: "Not order, but orderly progress, represents the social ideal."

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